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No. 368

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

MARGARET BATTS TOBIN

COMMISSIONER OF INTERNAL REVENUE,
Petitioner

v.

EDGAR G. TOBIN

Brief of the Respondents Margaret Batts Tobin and Edgar G. Tobin Opposing the Granting of the Writ of Certiorari

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OPINIONS BELOW

The findings of fact and opinion of The Tax Court, R. 77-123, are reported at 11 T. C., 928.

The opinion of the court below, R. 435-438, is reported at 183 Fed. (2), 919.

STATEMENT

The facts were correctly found by The Tax Court and summarized by the Court of Appeals. Some of the facts are stated in the Petitioner's brief, but the statement is incomplete and therefore does not fairly present the case. For instance, in the Petitioner's description of the Harriet Fiquet Batts Trust and the Ethel Murphy Tobin Trust he does not point out the substantial differences in the beneficiaries of those Trusts (Pet. Brief p. 9). These are described accurately in the findings of fact of The Tax Court, R. 89-91.

The Petitioner's brief also fails to refer to the fact that as stated in the opinion of the Court of Appeals, R. 437, Edgar Tobin has relinquished and renounced any right to share in the income of the Edgar Tobin Trust and the Harriet Fiquet Batts Trust. This relinquishment was brought to the attention of the Court of Appeals by a motion filed on behalf of taxpayers in that Court and was one of the points upon which the Court based its conclusion, (R. 437). This motion has not been brought up to this Court by the Petitioner as a part of the record.

In view of such deficiencies in the statement of facts contained in the Petitioner's brief, the Respondents refer to the findings of fact and opinion of The Tax Court and to the opinion of the Court of Appeals for a complete statement of the facts.

As a further guide to a ready understanding of the facts and of Respondents' position which prevailed in the Court of Appeals, there is printed as an

Appendix the Respondents' original brief in the Court of Appeals.

ARGUMENT

The Petitioner's position is based upon the proposition that a conflict "in principle" exists between the decision of the Court of Appeals for the Fifth Circuit in this case and the decision of the Court of Appeals for the Second Circuit in the case of *Lehman* vs. *Commissioner*, 109 Fed. (2), 99 (C. A. 2); certiorari denied, 310 U. S., 637. The Court of Appeals clearly did not deem its opinion to be in conflict with the rule of the Lehman case, a rule which is not disputed in the opinion of the Court of Appeals, but which is found to be inapplicable to the facts here presented. It is for that reason that we have referred particularly to a complete statement of the facts in the opinions below.

We submit that the Petitioner's argument is based upon a misunderstanding of the doctrine of the Lehman case. In the Lehman case, page 100, the court said:

> "The fact that the trusts were reciprocated or 'crossed' is a trifle, quite lacking in practical or legal significance. * * * The decisive point is that the decedent by transfer of his share to the brother * * * caused the brother to make a transfer of the property in trust under which the decedent had the right to withdraw $150,000.00 from principal. * * * Section 302 (d) * * * clearly covers a case where the decedent by paying a *quid pro quo* has caused another to make a transfer of property with enjoyment subject to it by exercise of such power by the decedent. See 52 *Harvard Law Review*, 1015."

The essential element is therefore the finding that the consideration for the creation of one trust was the creation of the other; that one was the *quid pro quo* of the other, *Lueders Estate*, 164 Fed. (2), 128. Such a finding is not present here. There is absolutely lacking here any finding of any fact, as fact, from which could result legally the conclusion reached by The Tax Court that each settlor was not the settlor as the trust indenture provided, but that a contingent beneficiary of income was the settlor. Indeed, the only finding of fact made by The Tax Court expressly negatives the theory upon which its conclusion was based, for The Tax Court found as a fact:

> "In 1935 Tobin and his wife, having in mind his former poverty and her family's recent financial reverses, decided each to try to protect as far as they were able to do so, the persons who were dear to them, respectively, against future financial want. *As a result*, Tobin and his wife in 1935 created from community property eight trusts of which five were created by Tobin out of his one-half of the community estate and three by his wife out of her one-half of the community estate." (R. 83-84).

The Court of Appeals likewise found that:

> "During the year 1935 Tobin and his wife, having in mind his family's financial insecurity and her family's financial reverses during the depression, decided to try to protect, as far as possible, their loved ones against financial want. With this end in view, in that year they created from their community property eight trusts, of which five were created by Tobin out of his one-

> half of the community estate, and three by his wife out of her one-half of the community property." (R. 436).

This, the only fact finding in the record, is therefore,

(a) That there was no consideration moving from one to the other;

(b) That the motivating cause for the creation of these spendthrift trusts was the protection by each separately of the persons who were dear to each against future financial want; and

(c) That each of the settlors Margaret Batts Tobin and Edgar G. Tobin, respectively, created such trusts from property which each of them owned at the date of the settlement of the trusts.

The Petitioner seeks to gloss over this fatal deficiency with a footnote, Petitioner's Brief page 15, in which he states that the missing finding is implicit in The Tax Court's conclusion. This argument might be acceptable if The Tax Court had been otherwise silent as to the reason for the creation of the trusts, but such was not the case. The Tax Court clearly stated that each trust was created for the good faith and sincere purpose of providing financial protection to those who were dear to the trustor and those to whom the trustor owed family obligations. As stated by the Court of Appeals, R. 437:

> "It is not even suggested that the trusts were originally created in bad faith, or with Federal tax consequences in mind."

No conflict of decisions can therefore be found in the refusal of the Court of Appeals to apply to such a fact situation the rule of the Lehman case which was devised, as stated by the Petitioner in his brief, page 12, "in order to neutralize one transparent device for the avoidance of taxes".

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS,
FIFTH CIRCUIT.

Number 12,884

MARGARET BATTS TOBIN, *Petitioner,*

VERSUS

COMMISSIONER OF INTERNAL REVENUE, *Respondent,*

EDGAR G. TOBIN, *Petitioner,*

VERSUS

COMMISSIONER OF INTERNAL REVENUE, *Respondent,*

(CONSOLIDATED)

Petitions for Review to The Tax Court of the United States, District of Texas.

ORIGINAL BRIEF FOR PETITIONERS

These two cases of husband and wife, respectively, come to this Court on separate petitions for review to the Tax Court, consolidated (R. 427) for the purpose of hearing here under a stipulation providing for such hearing in one record.

The fact issues in the case are simple, and were correctly found by The Tax Court, so that the cases involve only questions of law.

During the year 1935, these petitioners created eight trusts, each of which trusts rendered for taxation correctly the income which it received for each taxable year, and paid the tax legally due thereon.

See *Title 26 U. S. Code* § *161.*

On an audit by a Revenue Agent, deficiency assessments were levied against the two petitioners individually for the years 1940, 1941 and 1943, respectively, based upon the finding by the Agent that the income of each of the eight trusts was legally the income of, and hence taxable to, the settlor.[1]

On appeal to the Tax Court, the conclusion of the Commissioner based upon the Agent's report was sustained as to four of the trusts, but reversed as to the other four. The case comes to this Court, therefore, upon this appeal in connection with the adverse holding of the Tax Court as to the *four trusts* only, with respect to which it was held that the trust income was properly taxable to the settlor: the Commissioner having filed no cross-petition with respect to the four trusts as to which the Court below held that he had erred.

---

[1] Each of the eight trusts was identical in leaving to the discretion of the Trustee and the Advisory Committee the payment of income—and, as a matter of fact, no income from any of the trusts now before this Court was ever paid except the sum of Five Hundred ($500.00) Dollars disbursed in 1935 for benefit of the beneficiary of the Margaret Batts Tobin Trust. See Petitioners' Exhibit 13, R. 382.

For the sake of brevity, we do not set out in this brief the text of each of the trust instruments, as they are correctly summarized in the opinion of the Tax Court (R. 86 et seq.).

The long opinion of the Tax Court, (R. 77 to 123, inclusive) makes only one concrete finding of fact which is here relevant, the remainder of the opinion being discussions of the written instruments evidencing the trust agreements, or matters having no particular bearing upon the case as now presented.[2] The fact finding to which we refer reads as follows (see R. 83):

> "Petitioners were married in 1926. They have one son, Robert Batts Tobin, who was born March 12, 1934. Tobin had been married before and had a daughter, Katharine, by his previous marriage. His father had died sometime before 1935 but his mother, Ethel Murphy Tobin, was still living. His parents had always been people of small financial means. Petitioner Margaret Batts Tobin was the daughter of Judge Robert L. Batts of the United States Circuit Court of Appeals for the Fifth Circuit (1917-1919) and Harriet Fiquet Batts of Austin, Texas. Judge Batts resigned from the bench in August 1919 and was thereafter the local attorney for the Gulf Oil Corporation and also represented other oil companies. He had been a man of financial means but during the depression which began in 1929 he had lost his fortune and was left with heavy debts. In 1935 Tobin and his wife, having in mind his former poverty and her family's recent financial reverses, decided each to try to protect as far as they were able to do so, the persons who were dear to them, respectively, against future financial want. As a result, Tobin and his wife in 1935 created from community property eight trusts of which five were created by Tobin out of his one-half of the com-

[2] A very large part of the opinion (See R. 118 et seq.) deals with the question of deductions for farming operations. No complaint is made hereof the adverse ruling on that point.

munity estate and three by his wife out of her one-half of the community estate."

Thus—and we think this should be pointed out in the beginning—there is no room here for suggestion that the trusts were created for the purpose of minimizing taxes, or for any motive, indeed, except that of discharging those purely moral obligations which ordinarily normal persons feel due to their dear ones whom they desire to protect against want.

ARGUMENT

I.

In each of the eight trusts, Alamo National Bank of San Antonio was named as Trustee. Each indenture provided for an Advisory Committee, the membership of which changed from time to time. See Petitioners' Exhibit 12 (R. 371). Also see Opinion below, R. 96-8. This Committee was vested with certain definite, but limited powers, including the right to remove the Trustee with or without cause, and the authority to direct the Trustee whether or not to distribute the income accumulating in each trust. The deficiency assessment levied against the settlor in each case was the result of the conclusion of the Revenue Agent that *Helvering* v. *Clifford*, 309 U. S. 331, required the finding that this circumstance—*although each trust was an irrevocable one and no income, in fact, ever distributed* from any of the four trusts involved in this appeal[3] (except the

[3] See R. 103.

inconsequential sum of $500.00 paid to Mrs. Tobin under the Margaret Batts Tobin Trust, R. 382, on August 6th, 1935)—caused the income, under Section 22(a) of the Revenue Code, to be taxable to the settlor. This was the contention of the Commissioner in the court below. We quote from his brief in the summary of his contention:

> "Where a trust instrument reserves to the grantors, as members of an Advisory Committee, the management and control of a trust—the corpus of which was set up from community property—the income of the trust is taxable to them under section 22(a) of the Internal Revenue Code as community income." [4]

See, also, opening statement of counsel for the Commissioner below, R. 154.

This contention was thoroughly analyzed and considered in the opinion of the Tax Court, where it was definitely rejected. With respect to the Commissioner's argument, the Tax Court said:

> "As we analyze the facts and circumstances attendant the creation and operation of the four trusts now under consideration, (i. e. the four trusts not involved on this appeal), it seems to us that the analysis narrows down to whether the fact that the grantor of each trust was also *one* of the three members of the respective advisory committees is a strong enough factor to compel us to find that the grantor continued to be the owner for the purposes of section 22(a). We do not think such a finding would be a true finding of the ultimate fact and so we do not so find. Any power that the grantor had as a

[4] See also R. 110.

member of the advisory committee was to be exercised in a fiduciary capacity. It was not a power expressly retained in the trust instrument to the grantor as an individual. Cf. *W. C. Cartinhour*, 3 T. C. 482; *Herbert T. Cherry*, 3 T. C. 1171, 1179. It would certainly be true also that the other two members of the advisory committee were acting in a fiduciary capacity. There would be no basis for holding otherwise. We, therefore, hold that the respective grantor of the four trusts now under consideration did not continue to be the owner of the trust property for the purpose of section 22(a). It follows that the respondent erred in taxing the income of these trusts to petitioners as community income."

In an analogous case, the Court of Appeals of the First Circuit, in *Commissioner* v. *Branch*, 114 Fed. (2d) 985, 987, 132 A.L.R. 839, said:

"Where the grantor has stripped himself of all command over the income for an indefinite period, and in all probability, under the terms of the trust instrument, will never regain beneficial ownership of the corpus, there seems to be no statutory basis for treating the income as that of the grantor under Section 22(a) merely because he has made himself trustee with broad power in that capacity to manage the trust estate."

The same Court, in *United States* v. *Morse*, 159 Fed. (2d) 142, said:

"As an original question it might have been supposed that, in the case of any trust recognizable and enforceable by a court of equity, the trust income would not be taxable to the grantor

except to the extent as specifically provided in sections 166 and 167. But *Helvering* v. *Clifford*, supra, makes clear that this proposition is subject to a qualification: Even where the case does not fall within the technical limits of sec. 166 or sec. 167 the broad sweep of sec. 22(a), defining gross income, renders the trust income taxable to the grantor where the benefits directly or indirectly retained by him coincide substantially 'with the normal concepts of full ownership'. However, in view of the statutory scheme as a whole, and of the careful language of the Supreme Court in *Helvering* v. *Clifford*, it would seem that the court meant to limit the application of the Clifford doctrine to rather exceptional and extreme cases."

In *Hall* v. *Commissioner*, Tenth Circuit, 150 Fed. (2d) 304, the Court said:

"While we may ignore the technical necessities of the law of trusts in the determination of what constitutes the realization of taxable gain under Section 22(a), *Helvering* v. *Clifford*, supra; *Losh* v. *Commissioner of Internal Revenue*, 10 Cir., 145 F. 2d 456, we may not ignore that which Congress has recognized unless fully justified by the realities of the particular case. By Sections 161, 162, 166 and 167 of the Internal Revenue Code, 26 U. S. C. A. Int. Rev. Code, secs. 161, 162, 166, 167, Congress has distinctly recognized a trust as a separate taxable entity, and has provided for the imposition of a tax on the trust income as such. The statute in meticulous detail has specified the conditions on which trust income is taxable to the donor, and the specifications contained in Sections 166 and 167 do not by their terms deny the right of a father to create a trust for the benefit of his family, and to retain unto himself broad powers of man-

agement and control over the corpus and income so long as he does not retain the power to revest the corpus or revert the income to his own economic benefit. See *Helvering* v. *Wood*, 309 U. S. 344, 60 S. Ct. 551, 84 L. Ed. 796."

In *Cushman* v. *Commissioner*, 2nd Circuit, 153 Fed. (2d) 510, the Court said:

"Fourth, the petitioner reserved to himself as grantor power to control retention or sale of trust property and to direct investment and reinvestment of trust funds, and he invested himself as trustee with the extraordinary power of entering into capital readjustments as well as all the ordinary trustee powers, including that the voting the stock held in the trust. Analytically the powers held in the two capacities are, because of those different roles, different. The powers held as trustee are, of course, held in a fiduciary relationship and must be exercised only in the best interests of the beneficiaries. The power to vote the stock held in trust may not be exercised by the trustee for his own purposes; and where such conduct is threatened, a court of equity will direct the voting of the stock. See 2 Scott, Trusts (1939) Sec. 193.1."

In *Jones* v. *Norris*, 10th Circuit, 122 Fed. (2d) 6, in considering a trust agreement in which the settlor had reserved the power to change the Trustee, and to direct the character of investments, and to control whether or not the income or any part of it should be paid to the beneficiaries, the Court again denied that the income was properly taxable to the settlor.

"In all cases wherein the courts have invoked the doctrine of the Clifford case to sustain the taxation of income from a trust estate to the grantor, the facts follow closely the Clifford case. *Helvering* v. *Hormel*, supra; *Cox* v. *Commissioner of Internal Revenue*, supra; *Helvering* v. *Dunning*, supra; *First National Bank of Chicago* v. *Commissioner of Internal Revenue*, 7 Cir., 110 F. 2d 448; *Thomason* v. *Helvering*, 8 Cir., 114 F. 2d 607, and *Penn* v. *Commissioner of Internal Revenue*, 8 Cir., 109 F. 2d 954. In each of these cases, the court was dealing with a short term trust in which the power of revocation, revestment or reverter was either expressly manifest by the terms of the trust instrument, or the powers of management were so absolute as to admit of no question of the right of economic benefit to the grantor. * * *

"It is true that in addition to the extensive powers of control and management granted by the trust, the trust instrument authorized the grantor to make such changes as he saw fit and proper in the management of the estate for the best interest of his beneficiaries, but such powers of change were limited to management and the power to revoke or retake any of the corpus or income was specifically denied to him.

"We find no difficulty in divining the purpose of the power to make changes in the management, when such power is not inconsistent with the irrevocable provisions of the instrument. If the trust be irrevocable, it is certainly beyond the power of the grantor to revest or revert, because the property (both corpus and income) by the terms of the trust instrument is to be distributed to the beneficiaries in person on its termination, or sooner in the discretion of the grantor."

The same Court, in *Armstrong* v. *Commissioner*, 143 Fed. (2d) 700, followed its ruling in *Jones* v. *Norris* saying that the doctrine of the *Clifford* case

> "does not mean that a father may not in good faith make a gift of property to his son under a trust in which he is the trustee and is vested with powers of control and management."

The decision of the Tax Court in this case was reaffirmed in the recent case of *Harvey C. Fruehauf*, Docket #8790, which will be reported in 12 T. C. In that case, the Tax Court said:

> "To justify taxation of the income of a trust to its settlor under section 22(a), the 'bundle of rights' retained by him must be so substantial that it can be said that he remained in substance the owner of the corpus. The trust instrument in question was irrevocable. The income beneficiaries and the ultimate distributees of the corpus were definitely fixed and could not be changed. The conditions as to payment or accumulation were likewise definitely fixed and were not subject to change. The possibility of a reverter of either corpus or income is so remote as to be of no significance for the purposes of taxation of the income. *Cushman* v. *Commissioner*, supra. Absent here are important factors influencing the decisions in *Stockstrom* v. *Commissioner*, 148 Fed. (2d) 491; certiorari denied, 326 U. S. 719; *Shapero* v. *Commissioner*, 165 Fed. (2d) 811; certiorari denied, 334 U. S. 844; *Commissioner* v. *Buck*, 120 Fed. (2d) 775, relied upon by the respondent. In the Stockstrom case, the settlor had the power to deal with the property as his own, to apportion or withhold income and to accumulate income in favor of the remainder-

man. The retained power over the purse strings, coupled with the extraordinary administrative powers, were regarded as sufficient to make the doctrine of the Clifford case applicable. In the *Buck* case, the settlor, in his individual capacity, had the power to alter or amend the trust indenture in respect to the income and corpus, and thus to 'sprinkle' it among any of the beneficiaries he might select. In the *Shapero* case, the grantor had the power 'to modify, alter, change or amend' in certain respects, as well as the power to control the drug company by voting the trusteed shares. These powers, in the court's opinion, enabled the grantor to use the trust corpus to his personal advantage, and were sufficient attributes of ownership to justify taxing the income to him under section 22(a) of the Code."

See, also, *Kent* v. *Rothensies*, 35 Fed. Sup. 291.

It is, we submit, perfectly clear that the court below was right in wholly rejecting the contention of the Commissioner, based upon the doctrine of the *Clifford* case.

So far as the four trusts are concerned as to which the taxpayers prevailed in the court below, no cross-petition was sued out. They are, therefore, not before the Court. But the ruling in respect of those four trusts, we respectfully submit, is applicable likewise to the four now before the Court, wherein the petitioners have appealed here, because of adverse ruling based upon another and entirely different contention never even suggested by the Commissioner, but raised wholly out of the minds of the Tax Court.

II.

Reference to the opinion of the court below (R. 110) discloses that *only two contentions were raised below by the Commissioner: (1) that the income of all eight trusts was taxable to petitioners under the Clifford rule, and (2) "the income of four of the trusts* (namely, the Edgar Tobin Trust; the Margaret Batts Tobin Trust; the Ethel Murphy Tobin Trust; and the Harriet Fiquet Batts Trust) *is also taxable to petitioners* as community income *under section 167(a)(2) of the Internal Revenue Code".*

The Tax Court disposed of both of these issues adversely to the contention of the Commissioner. It would seem that, so doing, a judgment for the taxpayers was required. *Helvering* v. *Wood,* 309 U. S. 344. For, as in that case, the same rule of fair play that induced there the decision adverse to the Commissioner is applicable:

> "to open here for the first time * * * an inquiry into the broader field is * * * to permit a shift to ground which the taxpayer had every reason to think was abandoned in the earlier steps of the litigation".

The complaint of this error of the Tax Court is raised here. See Assignment of Error Number 13 (R. 31).

The Tax Court, however, after concluding that none of the Commissioner's contentions had basis, conceived out of its own head—without pleading, or without suggestion, orally or in brief—a ground which evidently the Commissioner did not think had merit; and decided the case against the taxpayers in

respect of the income of the four trusts just mentioned upon the doctrine of "reciprocal trusts," relying upon *Lehman* v. *Commissioner*, 109 Fed. 2d) 99 (R. 112). The Tax Court, disregarding the plain language of the written instruments evidencing the trusts, reasoned this way: "Edgar Tobin was 'in substance' the trustor of the trust of which his wife's mother, Harriet Fiquet Batts, was the beneficiary; that Margaret Batts Tobin was likewise 'in substance' the trustor of the trust of which her husband's mother, Ethel Murphy Tobin, was the beneficiary."

Now the trust which Tobin had created to take care of *his* mother provided for payment of income to Margaret Batts Tobin, but this, only at the discretion of the Advisory Committee. The Harriet Fiquet Batts trust provided, likewise, for payment of the income to Edgar Tobin, if and when the Advisory Committee should so direct. It is to be noted that there is no contention here that any of such income was ever so paid, or that the Trustee ever decided to pay any, or that the Advisory Committee ever directed the Trustee to pay any, except the sum of $500 paid to Mrs. Tobin on August 6, 1935 (R. 382).

The corpus of the trust in each case was to the beneficiary named, *i. e.* Margaret's to *her* mother; Edgar's to *his* mother.

Yet, the Court below placed its reliance upon a decision adverse to the taxpayers, upon the fallacious ground that the *Lehman* case required a holding that the trusts were reciprocal, so that

> "In substance Margaret Batts Tobin was the trustor of the Ethel Murphy Tobin Trust and Tobin was the trustor of the Harriet Fiquet Batts Trust."

Having so held, the Court concluded that under Section 167(a)(2) of the Revenue Code, the income of each trust could

> "in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such * * * income have been distributed to the grantor."

It must be apparent, however, that if Margaret Batts Tobin was in fact the trustor of the Harriet Fiquet Batts trust, and if Edgar Tobin was in fact the trustor of the Ethel Murphy Tobin trust, then there would be entirely lacking any substance for the contention that any part of the income could have been distributed to the grantor by anyone. Resort to the fiction of cross-trusts became necessary in order for the court to arrive at any conclusion that the grantor in either case could have been entitled to any part of the income of the trust created by him or her. Let us, therefore, examine the *Lehman* case to see whether there is any authority for the conclusion reached below.

In that case, 109 Fed. (2d) 99, the Court of Appeal of the Second Circuit had before it a decision with respect to *estate,* not income, taxes. There two brothers, Allan and Harold Lehman, each had owned equal shares in certain securities. Harold, the decedent,

"agreed to transfer his share in trust for Allan and his issue, in consideration of Allan transferring his share in trust for the decedent and his issue."

The Court held:

"The decisive point is that the decedent by transfer of his share to the brother * * * caused the brother to make a transfer of property in trust under which the decedent had the right to withdraw $150,000 from principal. * * * section 302(d) * * * clearly covers a case where the decedent by paying a *quid pro quo* has caused another to make a transfer of property with enjoyment subject to change by exercise of such power by the decedent. See 52 Harvard Law Review 1015."

The Court disposed of the contention that the trusts were "reciprocal" as being utterly insignificant.

"The fact that the trusts were reciprocated of 'crossed' is a trifle, quite lacking in practical or legal significance."

Thus, no conclusion can be reached from the *Lehman* case other than this:

(a) that the fact that trusts are reciprocal is of no legal significance whatsoever,

(b) that the decision there was based upon one trust constituting the entire consideration for the other.

In other words, that Brother A had turned over his property to Brother B to be used as a trust in favor

of A, *in consideration* of B likewise turning his property over to A, so that A, *in exchange*, would make a similar trust in favor of B.

The *Lehman* case, therefore, is no authority for holding that the mere fact that the trusts are reciprocal or crossed is material. That case proceeds upon the common sense doctrine that the law looks through form to substance, and that, where one trust is made *as the legal consideration* for the establishment of the other, the form will be disregarded.

In *Commissioner* v. *McLean*, 127 Fed. (2d) 942, this Court had before it, in a gift tax case, the principle which would be controlling here under the *Lehman* case. The taxpayer and his wife had executed simultaneously transfers in trust to each other, which they contended here were made "for adequate and full consideration in money and money's worth". The Commissioner, however, holding that no consideration had passed, taxed the transfers as completed gifts. The Board of Tax Appeals had rendered what, for the purposes of this case, may be styled a split decision, from which both parties appealed to this Court, which found no difficulty in holding that the transfers were not based upon mutual consideration, but were

> "donative in intent and in effect. * * * and effected as to the donor a taxable gift to the extent and value of the estates and interests in the property then transferred."

Applying the rule in the *McLean* case here, it would seem clear that the *Lehman* case could not be applicable, for the plain reason that what controlled the latter case, *i. e. mutual consideration*, is wholly lacking. Such was the decision of the Court of Appeals of the Third Circuit in *Lueders' Estate*, 164 Fed. (2d) 128, wherein the Court reversed another decision of the Tax Court, based upon its theory of reciprocal trusts under the *Lehman* doctrine, in the case of trusts created by husband and wife reciprocally in favor of each other. The Court there held the *Lehman* doctrine required the presence of *a legal consideration* moving from one settlor to the other.

> "It is the presence of legal consideration which makes a transfer of property a sale and the absence of consideration which makes a transfer a gift. Further, that gifts are such even though there was concerted action with respect thereto by the parties interchanging them.
>
> "As to the Tax Court's conclusion that 'the decedent was under a moral obligation to provide her husband with assets when he became in need' such 'moral obligation' is insufficient to constitute legal 'consideration' by the great weight of authority in the United States."

Again:

> " 'Quid pro quo' in its common acceptance means 'something for something; an equivalent in return; a consideration in the contract' as defined by Webster. Bouvier defines it as 'a term denoting the consideration of a contract'. Consideration, in a contract, is the quid pro quo

that the party to whom the promise is made, does or agrees to do in exchange for the contract.

"Since both trusts were executed in New Jersey, the domicile of their settlors, the definition of 'consideration' in the Restatement of the Law of Contracts, Sec. 75, with which New Jersey is in accord is of interest: '(1) Consideration for a promise is (a) an act other than a promise, or (b) a forbearance, or (c) the creation, modification or destruction of a legal relation, or (d) a return promise, bargained for and given in exchange for the promise'.

"An examination of the record and of the Court's opinion fails to disclose the presence of any of these elements constituting consideration in the creation of the two trusts."

It is true that in the *Lueders* case, the trusts were created fifteen months apart; but that that fact was not of controlling significance in the decision appears from the language of the Court:

"*That consideration is the decisive factor and must be present in order to make the Lehman doctrine applicable* was ruled by the Tax Court in *McLean* v. *Commissioner*, 41 B. T. A. 1266, affirmed 5 Cir., 1942, 127 F. 2d 942, and *Estate of Samuel A. Lindsay* v. *Commissioner*, 1943, 2 T. C. 174.

"In the *McLean* case, 41 B. T. A. at page 1267, the Board, after holding the Lehman doctrine inapplicable, specifically ruled 'The fact that the trusts were created at the same time and contained recriprocal provisions does not prove that one was created in consideration of the other, and the fact that the transfers were in

equal amounts and made at the same time does not show that one was made in consideration of the other."

In the *Lindsay* case, 2 T. C. 174, the Tax Court held that under the decision of this Court in the *McLean* case, neither the fact that trusts executed by husband and wife to each other were executed about the same time, were in substantially equal amounts, and had similar provisions, would not be conclusive that the trusts were executed in consideration of each other; and therefore held the *Lehman* doctrine inapplicable.

The present opinion of the Tax Court is completely silent with respect to any finding that any consideration moved from one settlor to the other, so as to make the Lehman doctrine applicable. And, as pointed out by Judge O'Connell in his dissenting opinion in the *Lueders* case, fact findings essential to the upholding of the deficiency assessment *must be found* by the Tax Court if its decision is to stand.

All that the Court does in the instant case is to conclude as a matter of law—not of fact—that Margaret was in substance the trustor of the trust wherein Edgar was the apparent settlor; and *vice versa*, that Edgar was in substance the trustor of the trust estate settled by Margaret. There is absolutely lacking here any finding of any fact, as fact, from which could result legally the conclusion reached by the court below that each settlor was not the settlor, as the trust indenture provided, but that a contingent beneficiary of income was the settlor.

In this respect, the decision now before the court is wholly inconsistent with that rendered by the Tax Court in *Lewis W. Welch*, 8 T. C. 1139, 1147. There, the court declined to apply the *Lehman* doctrine to a case where husband and wife, on the same date, had created two trusts for the benefit of their two children. The Commissioner had contended

> "that for the purpose of this proceeding petitioner '(husband)' must be considered as the real grantor of the trusts created by the wife for the benefit of the two daughters".

The property transferred by the wife being certain shares of corporate stock given by the husband to the wife on the same day of the creation of the two trusts, the Court said:

> "There is no evidence in the record that the transfer to the wife was conditioned upon her creating the trusts and we know of no reason why we should assume that such was the case.
> * * *
>
> "We must hold that under the facts which have been stipulated" (i.e. that gift tax had been paid upon the gift from the husband to the wife) 'Marion Edith Welch became the unconditional owner of those 30 shares of Novi stock by virtue of the gift and had the right to do with them as she pleased after she received them. We further hold that petitioner can not be regarded as the grantor of Trusts Nos. 5 and 6' (those created by the wife) 'and is not taxable upon the income therefrom.' "

It would seem that where a husband donated to his wife the property which was to become the corpus of a trust estate in favor of their common children, when on the same date the husband was making a like gift in trust to these children, there would be a stronger case for holding that the trusts were reciprocal than there would be where husband and wife each gave in trust property in fact owned by each settlor respectively. Yet the fact that the subject matter of the wife's trust, executed contemporaneously with her husband's, was a gift from her husband made on the same day of the execution of the two trusts, was held of no significance. This, from the same court which here taxes the husband as the settlor of a trust created by the wife, and the wife as the settlor of a trust created by the husband, with absolutely no finding of fact which could call into play the doctrine of the *Lehman* case, upon which the decision below rests.

Indeed, the only fact finding made by the lower court expressly negatives the theory upon which its conclusion was based. For, as pointed out in the beginning of this brief, it was found as a fact:

> "In 1935 Tobin and his wife, having in mind his former poverty and her family's recent financial reverses, decided each to try to protect as far as they were able to do so, the persons who were dear to them, respectively, against future financial want. *As a result*, Tobin and his wife in 1935 created from community property eight trusts of which five were created by Tobin out of his one-half of the community estate and three by his wife out of her one-half of the community estate."

This—the only fact finding in the record—is therefore (a) that there was no consideration from one to the other; (b) that the motivating cause of the trusts was the protection by each, separately, of the "persons who were dear", against future financial want; and (c) that each of the settlors, Mr. and Mrs. Tobin respectively, created such trusts from property which each of them owned at the date of the settlement of the trusts.

What we have said respecting the trusts created for the protection by the wife of her mother, and of the husband of his mother, is applicable likewise to the other two trusts which are before the Court wherein the wife undertook to protect her husband, and the husband his wife. There is here, likewise, not a semblance of any finding of fact from which a conclusion could be drawn that the expressed intention of each trust indenture should be ignored, and that the settlor of Trust A should be considered, in law, the settlor in Trust B, and *vice versa*. The Tax Court simply reaches a conclusion based upon no finding of fact whatever.

But there is no basis for their conclusion, since the record is absolutely void of any proof that consideration moved from one settlor to the other as an inducement for the creation of reciprocal trusts. On the contrary, the fact finding is otherwise.

That the settlors were, respectively, husband and wife is of no legal significance. There is nothing in the law of Texas to prohibit the creation by the husband of a trust in favor of his wife; nor, for that matter, by a wife in favor of her husband.

See cases cited by Judge Hutcheson in *Commissioner* vs. *Porter*, 148 Fed. (2d) at pages 567-8.

In the *Porter* case, this Court pointed out (page 568) that income in the hands of trustees and not distributed, does not fall into the community. In the cases at Bar, it is conceded that no part of the income of any of the trusts was ever distributed except the sum of Five Hundred and No/100 ($500.00) Dollars, mentioned in the early part of this brief and which was paid to Mrs. Tobin under the Margaret Batts Tobin Trust in 1935, a year in no wise involved here. The balance remained in the hands of the Trusts each of which paid income tax thereon as a legal entity, and each of which retained the entire income in its hands. None of this income during the years here involved ever reached a beneficiary; and hence it is plain that no part of such income could have fallen within the purview of the community property statutes so as to place it under the control of the husband.

McClelland vs. *McClelland*, 37 S. W. pages 350, 358.

Very plainly the purpose of each of these trusts was, as each indenture plainly states, to provide for the beneficiary adequate protection against misfortune or improvidence. Any income actually distributed to a beneficiary would, of course, fall within the grasp of the community property law and be taxable as such. But, as long as such income remained undistributed, it is plainly the property of the trust and in no sense that of the beneficiary—especially so, in view of the provision in each of the two instru-

ments under which the trustee was without authority to distribute any part of the income unless so directed by the Advisory Committee.

Plainly, if undistributed income held in a trust for the protection of the beneficiary against the accidents of life or poor business judgment, should be held to be property subject under the law of the State to debts of the community, this would be clearly to defeat the express purpose of the creation of such trust. See authorities cited in footnotes 9 and 10 to the *Porter* case, pages 568-9.

CONCLUSION

In conclusion, it is respectfully submitted that the decision below is erroneous, and should be reversed.

Respectfully submitted,

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Attorneys for Petitioners.

This is to certify that copies of this brief have been served on opposing counsel on this the..... day of January, 1950.

.....

APPENDIX

United States Code, Title 26, (Internal Revenue Code), *Section 161.* (a) *Application of Tax.*

The taxes imposed by this chapter upon individuals shall apply to the income of estate or of any kind of property held in trust, including

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and payment.*

The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

Section 166. Revocable trusts.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor. (53 Stat. 68.)

Section 167. Income for benefit of grantor.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies

of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution": deduction); then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

(c) Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income, in the discretion of another person, the trustee, or the grantor acting as trustee or co-trustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered paid out of income to the extent of the income of the trust for such taxable year which is not paid, credited, or to be distributed under section 162 and which is not otherwise taxable to the grantor. (53 Stat. 68, 58 Stat. 51.)